Attachment B

GAO Report dated September 1998
Federal Housing Finance Board Actions Needed to Improve Regulatory Oversight

ERRATA

Page	**Misstatement, inaccuracy or overstatement**
3, 26	The characterization of System risks on page 3 is biased and inconsistent with the more generic description of those risks on page 26. The point that should be made is that the Finance Board has rules, regulations and policies, particularly the Finance Board's Financial Management Policy (FMP), that set forth how the Banks will limit and manage risk, not that the Banks have a variety of ways to manage risk.
3, 27-28	Proposed legislation would not result in additional business risk for the System. It would simply expand types of eligible collateral and ease membership requirements for community banks.
3	The Finance Board is involved in the "initial selection" of FHLBank Presidents only to the extent that the Finance Board approves that selection as required by statute. The Finance Board does not make the selection, nor does it participate in the selection process.
5, 7-8, 52, 56-57, 59, 76	The statement that the Finance Board lacks clear enforcement policies and procedures is misleading. There are enforcement tools set forth in the statute and in the agency's regulations and the agency has examination policies, and procedures for dealing with examination findings. The Finance Board has the ability to suspend or remove for cause directors, officers, employees or agents of any FHLBank; has the authority to promulgate and enforce such regulations and orders as are necessary to carry out the provisions of the FHLBank Act; and has the authority to liquidate or reorganize any FHLBank if it finds that the efficient and economical accomplishment of the purposes of the FHLBank Act will be aided by such action. The fully enumerated powers given to the other federal financial institution regulatory agencies and the other GSE regulatory agencies would be useful additions, but the Finance Board can fulfill its responsibilities with the current authorities. Furthermore, there is no meaningful way to devise mandatory "cookie-cutter" enforcement actions. Even Prompt Corrective Actions (which require certain actions to be taken in certain circumstances) and Civil Money Penalty matrices involve the exercise of judgment based on the situation involved including deciding whether the threshold for action has been reached.

5, 7, 52-53, 55, 75-76 Statements that the Office of Supervision (OS) does not coordinate its monitoring and other effort with Office of Policy (OP) are false. The OP is responsible for collecting, verifying and presenting monthly and quarterly data on the financial condition and financial performance of the individual Banks and the System as well as the System's statutory housing programs and membership. OP ensures that these data are available to all offices, other regulatory agencies and the FHLBanks. These data are the basis for OS's Trendbook (System and Bank ratio analysis) and OP's Profile Book (System and Bank financial tables and graphs, and System and individual Bank analysis). Although these two analytical tools serve different purposes, the primary data for both are the same and the two products are complementary. OS and OP staff members discuss and review outstanding issues for specific Banks during pre and post-examination meetings. OS examiners are in frequent contact with OP analysts regarding regulatory compliance issues. In certain instances, OS has formally referred compliance issues to the Office of General Counsel (OGC) and OP for resolution.

5, 8-9, 66-68, 77 Statements that the Finance Board is involved in System business beyond what is required by statute are false. The Finance Board's strategy of fulfilling its statutory mandate to ensure that the FHLBanks carry out their housing finance mission by actively encouraging the development of mission-related activities by the FHLBanks is entirely consistent with its statutory charge, and represents the regulator seeking to encourage maximization of the public benefit through the stimulation and authorization of financially safe and sound, innovative tools and products. This necessarily involves it in System business to an appropriate degree, while not governing the management of the FHLBanks.

5, 9, 66-67 The first example of the Finance Board's business involvement is that there is not enough emphasis on safety and soundness in the agency's Strategic Plan. This is inaccurate, has absolutely nothing to do with coordination and promotion and does not support the conclusion.

5, 67 The second example of the Finance Board's business involvement is the reference in the Strategic Plan to the agency's marketing clearinghouse function to help the FHLBanks develop new products and services. The statement that the Finance Board advocates that the FHLBanks undertake specific activities, implicitly to the detriment of other, more appropriate, activities, is completely unsupported.

5, 9, 67-68 The third example of the Finance Board's business involvement is that the Chairman of the Finance Board meets with the Finance Board appointed Chairs and Vice-Chairs of the FHLBanks. The conclusion that the Chairman coordinates the Congressional lobbying efforts of the Finance

Board appointed Chairs and Vice-Chairs of the FHLBanks is based on topics listed on an agenda for such a meeting, but the actual conduct at the meeting was never reviewed with participants.

5, 9, 68 The fourth example of the Finance Board's business involvement is that the Finance Board coordinated the 1998 annual FHLBank director's conference. This conclusion is based on flawed logic.

5, 9, 66-67 Statements concerning the Strategic Plan are inaccurate. The safety and soundness of the Federal Home Loan Bank System is the priority of the agency and is reflected in several goals of the Strategic Plan. Goal I focuses on the Office of Supervision; Goal II, Objective A on a legislative agenda which will enhance the safety and soundness of the FHLBank System; Goal II, Objective D on the pilot approval process; Goal II, Objective E on revision of the Financial Management Policy, including investments, which addresses all aspects of risk: and, Goal III, Objective B on activities in all compliance monitoring. Further, implications or statements that the Strategic Plan offers some proof that agency resources were directed away from examinations toward inappropriate "promotional" efforts are totally without substance.

6-7, 45 Equating internal control problems of a FHLBank to the internal control problems that have caused severe losses at other financial institutions is a serious overstatement of the segregation of duties problems Finance Board examiners found. Internal control problems at other financial institutions involved inadequate segregation of trading and back office operations. Unlike these financial institutions, the FHLBanks are wholesale lenders that do not even engage in trading operations.

7, 28 The statement that Community Investment Program (CIP) and Affordable Housing Program (AHP) advances represent 1 percent of assets is not provided in the appropriate context. The AHP and CIP numbers used by GAO represent new advances made in 1997. Comparing new CIP and AHP advances, or the volume for the year, with total assets outstanding at year-end is not an appropriate comparison. It is more appropriate to compare outstanding CIP advances with outstanding assets and to measure AHP activity by the amount of subsidies granted. For 1997, average CIP advances outstanding were $6.7 billion. This is equivalent to 2.1 percent of the average assets outstanding of $311.9 billion, and 3.9 percent of the average advances outstanding of $171.0 billion for 1997. More than 90 percent of Affordable Housing Program (AHP) subsidies are in the form of direct grants and less than 10 percent are in the form of subsidized advances. Since the vast majority of AHP subsidies are not advances, it is not appropriate to measure AHP against FHLBank assets or advances. At December 31, 1997, total AHP subsidies outstanding were $638.6 million. These funds will assist in the purchase, construction, or rehabilitation of

164,550 housing units. The estimated development cost of this housing is more than $10.5 billion.

5, 9-10, 18, 60-64, 76 Statements that the Finance Board is not an arm's-length regulator are false. See comments on page 2, "Statements that the Finance Board is involved in System business...."

12 The statement that System capital is less suitable for absorbing losses than other forms of capital because it is redeemable by members under certain circumstances is misleading. Forty-two percent of the System's capital stock ($8.2 billion) is held by mandatory members and is not redeemable under any circumstances. Voluntary members may withdraw from membership and redeem their capital stock six months after giving notice to do so and members that withdraw from membership may not re-apply for membership for 10 years. If at any time, the Finance Board finds that the paid-in capital of a Bank is or is likely to be impaired as a result of losses in or depreciation of the assets held, the Finance Board can order the Bank to withhold from the amount to be paid in retirement of capital stock a pro rata share of the amount of such impairment as determined by the Finance Board.

22 The discussion of the implied government guaranty of the FHLBank System's consolidated obligations should, as do other GAO reports, include a statement that the Bank Act explicitly required that all such obligations clearly state that they are not obligations of the United States and are not guaranteed by the United States. See 12 U.S.C.A. § 1435.

22 Statement of who used to be and who may be a member of a FHLBank is wrong. Prior to FIRREA, "any building and loan association, savings and loan association, cooperative bank, homestead association, insurance company, or savings bank" subject to certain circumstances, was eligible to become a member or a nonmember borrower of a FHLBank. FIRREA expanded this list to include "any insured depository institution," which, by definition, included commercial banks and credit unions. See 12 U.S.C.A. § 1424(a).

25 The Vice Chairman of each Bank is designated by the Finance Board as required by statute, see 12 U.S.C.A. § 1427(g), upon recommendation by the board of directors of each Bank.

25 Explanation of consolidated obligations and who can issue them is wrong. Individual FHLBanks have no statutory authority to issue consolidated obligations and do not do so. See 12 U.S.C.A. § 1431

25 The statement that the System issued $2 trillion in debt in 1997, replacing Treasury as largest issuer of debt is out of context and gives a false

impression about the size of System debt. Based on outstanding debt, which is a more comparable measure, the System is fourth largest behind Treasury, Fannie Mae and Freddie Mac.

27	The "government" did not afford the FHLBanks lien priority – the Congress did in the statute.
28-29, 47, 63-64	Statements about the Finance Board "promoting" certain activities may be correct insofar as the agency continues its efforts to move the FHLBanks' business, investments and balance sheet away from non-mission-related activities and toward more mission-related activities. However, implications that the Finance Board has "promoted" or "directed" that the FHLBanks engage in specific activities, or that the FHLBanks engage in one mission-related activity over another, or that the FHLBanks engage in an activity at the expense of another activity, are false.
28	The System has no "charter" other than the Bank Act; the "purpose" of the System is only indirectly laid out in the Bank Act. Rather, the responsibilities and duties of both the FHLBanks and the Finance Board are set forth in the statute.
28	The statement that the System's activities have "expanded" is not correct. See "The statement that the Finance Board has expanded the FHLBanks' investment authority is false" below.
28	The statement that the Bank Act sets AHP priorities is wrong. The Bank Act requires the Finance Board, by regulation, to specify priorities.
28-29	The characterization of CIP pricing is wrong. CIP loans must be made at the cost of consolidated obligations with similar maturities, taking into account reasonable administrative costs. There is nothing in the statute about a discount.
29	The statement that the Finance Board has expanded the FHLBanks' investment authority is false. The Finance Board has clarified its interpretation of what the investment authority is. The comparison of growth in advances vs. growth in investments between 1989 and 1997 does not provide an accurate picture of what happened over the time period. Advances continued to decline between 1989 and 1991 dropping 44 percent and reaching a low of $79 billion before beginning to increase. Between 1991 and 1997, advances increased over 150 percent. The GAO comparison also does not acknowledge that during this time period, the Banks had to compensate for lost earnings on $2.5 billion of retained earnings as well as generate enough income to meet the annual $300 million Resolution Funding Corporation (REFCorp) and $100 million (or

10 percent of net income if greater than $100 million) AHP payments required by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA). The Banks also used to generate earnings sufficient to service free capital of newly authorized members who joined quickly, but borrowed slowly.

29 The statement of the objectives of the GAO audit is inconsistent with other statements of those objectives elsewhere (i.e., in the GAO statement of work, in the Report on pages 2 and 18-19).

31 The statement that GAO met with appropriate Finance Board officials is false. The GAO failed in numerous instances to discuss its findings with responsible officials and failed and refused to conduct a proper exit conference.

49 The statement that the Finance Board has no concrete proposals regarding the issue of FHLBank investments is disingenuous. Finance Board staff has devoted a great deal of time, analysis and thought to the issue and of how to deal with it. This is demonstrated in the staff paper published in the Federal Register, as well as in numerous provisions of S. 1423, which include detailed capital and other provisions designed to improve the FHLBanks' operations and which were developed, at the request of Congressional staff, with much input from Finance Board staff.

55 The statement that various reports produced by OP and OS are Systemwide rather than Bank-by-Bank is incorrect. GAO relied on uncorroborated statements of staff rather than reviewing the documents for themselves to determine the accuracy of those statements. The reports prepared by OS and OP provide System as well as Bank-by-Bank analysis.

58 There is no way to "informally" resolve disputed supervisory determinations.. According to the procedures adopted by the Finance Board for such resolutions, disputed matters must either go to the Board of Directors of the Finance Board for review or for approval of any settlement agreement.

60 Statement that after FIRREA, the Bank Act maintained **many** of the remnants of the old Federal Home Loan Bank Board, and that the Finance Board, like its predecessor, remains involved in FHLBank System business, are gross overstatements.

60-61 References to "business" functions should be changed to "management" functions.

62-63	The Farm Credit Administration also has statutory authority to regulate appointments of presidents and other employees, as well as salary scales and other compensation. Implications to the contrary are false.
63	The implication that retaining authority to approve appointments of Bank Presidents appears to give the Finance Board interest in an individual's appointment and could complicate removal if needed is not accurate. The Finance Board approves recommendations made by FHLBank boards of directors and has no vested interest in any individual President.
63	The characterization of the compensation regulation is outdated in its reference to CIP. In January 1997, the compensation regulation was revised to provide the Banks' boards of directors more flexibility in setting incentive plan goals.
64	The statement attributed to FHLBank officials that "devolution efforts are more form than substance" is unsubstantiated and is false.
77	The conclusion that the Finance Board doesn't give the proper priority to its role as safety and soundness regulatory is wholly unsupported, unsupportable and false.